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STATE OF MONTANA

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To: The Governor's Advisory Council on School Funding

From: Amy Carlson

RE: Analysis of proposed school funding revisions

This paper analyzes the proposal discussed at the end of the November 1 meeting and further defined by Madalyn Quinlan via e-mail in mid November. The following overview explains this draft proposal.

Overview of the Council's draft proposal

Definition of General Fund BASE Budget

- 80% of the basic and per-ANB entitlement (current law)
- 140% of state special education payment (current law)
- district transportation budget as determined by the trustees
- district retirement budget as determined by the trustees
- district health insurance costs as determined by the trustees (currently a general fund expense item within the entitlements, this paper assumes this is in addition to current entitlements)

State monies would fund the general fund BASE budget through direct state aid, state special education payments, transportation, and guaranteed tax base aid applied to a countywide levy to fund the portion of the BASE budget not funded by direct state aid and state special education payments (to include transportation, retirement and health insurance).

Definition of Maximum General Fund Budget

- 100% of the basic and per-ANB entitlement (current law)
- up to 200% of state special education payment (current law)
- district transportation budget (same as the BASE budget)
- district retirement budget (same as the BASE budget)
- district health insurance costs (same as the BASE budget)

The over-BASE levy would allow a district to fund the 20 percent of the entitlements between 80%-100% and special education costs between 140 - 200%. No over-BASE levy for transportation, retirement and health insurance will be permitted because the full cost of these three items would be included in the BASE budget. Fund balance re-appropriated and district sources of non-levy revenue would now be applied to the over-BASE budget.

Technical Details

Countywide equalization has technical issues that need further research. These issues include: weighted or non-weighted GTB, fund balance requirements of the county and the district and other issues. These issues will have financial implications for the state, county, and districts.

Financial implications of BASE budget changes

Countywide Equalization and the elimination of HB 124 block grants in the General Fund

Countywide equalization sums the BASE budgets of all districts within a county and funds them by county instead of by district. The state funds a portion of the BASE amount with Direct State Aid. The remaining portion of the BASE, called the Guaranteed Tax Base Area, is shared between the county and the state. The state equalizes the value of a mill relative the BASE budgets up to 175% of the statewide average.

Countywide equalization requires less state General Fund than district equalization because county taxable values are more equal than district taxable values. In other words, fewer taxpayers are substantially below the 175% guarantee level and less state funds to are required to bring all counties up to this level. At the same GTB percentage, county taxpayers will pay a higher proportion of the GTB area than will district taxpayers. The GTB percentage can be increased to return the balance between local and state taxpayers.

Elimination of the HB124 block grants frees \$25.5 million in state resources that can be used for equalization of the newly defined BASE budget.

The combination of county equalization and elimination of HB 124 block grants to the district general fund budgets, nets a savings to the state of **\$31 million**. This state savings is offset by an increase to local property taxes of the same amount.

The Council could recommend changing the GTB percent to increase or decrease the state cost. If costs of equalizing other portions of the budget such as transportation, retirement, or health insurance cost the state additional funds, the GTB percentage could be reduced in order to keep the costs neutral. Likewise, if the expenditures in Table 1 cost less than this \$31 million, then the GTB percentage could increase to make the costs neutral.

<p align="center">Summary of Financial Implications for Draft Proposal with GTB at 175%</p> <p align="center">Table 1</p>

Item	Impact to the State (in millions)	Impact to the Local property taxpayers (in millions)
Countywide equalization of BASE budgets, no change in GTB	\$31	-\$31
Transportation as in draft proposal	-\$10	\$10
Retirement as in draft proposal	-\$5	\$5
Health Insurance as in draft proposal, no change in overBASE budget	-\$26	-\$34
Net impact to the state and local taxpayers	-\$10	-\$50
Net impact to district budgets (due to health insurance)		\$60

Transportation

Proposal

Under the Council's draft proposal assumptions outlined by Madalyn Quinlan, the State would continue to pay approximately \$11 million of currently defined on-schedule costs.

In addition, the state would participate in the remaining transportation costs through GTB aid. If total transportation budgets were \$55 million, then after \$11 million of state transportation aid and \$7 million from non-levy revenue and fund balance re-appropriated are used, the remaining \$37 million would be split between the state and counties. With the GTB percentage set at 175%, the state-county split is approximately 43% state and 57% county. The GTB cost to the state would be approximately \$16 million (43% of \$37 million). Current HB124 transportation block grants of \$6 million could be used to offset the \$16 million GTB expense for a net **\$10 million** additional cost to the state.

<p align="center">Transportation Funding Summary</p> <p align="center">Table 2</p>

This **\$10 million** increase to the state would be offset by local property tax reductions. There is no increased expenditure by districts.

Table 2 summarizes these calculations.

Funding	Current	Proposed	Alternative
State			
Direct State	\$ 11	\$ 11	\$ -
HB 124	\$ 6	\$ -	\$ -
GTB	\$ -	\$ 16	\$ 21
Total state	\$ 17	\$ 27	\$ 21
Local	\$ 38	\$ 28	\$ 34
Total	\$ 55	\$ 55	\$ 55

Alternative

If the entire transportation budget were instead funded with GTB and no direct state aid, the \$55 million less non-levy revenue and fund balance re-appropriated of \$7 million

would be split between the state and the county. The state cost of this plan would be approximately \$21 million. The increase from current state expense is **\$4 million**.

Retirement

Under the draft proposal, retirement continues to be equalized at the county level, but is equalized at 175% GTB instead of 121%. Under current law, the state pays approximately 26% of the GTB area of retirement costs. Under the draft proposal, the state would pay approximately 43% of the GTB area of retirement.

Retirement budgets are approximately \$100 million per year and are first funded with non-levy revenue and fund balance re-appropriated. The non-levy revenue is approximately \$7.5 million without HB 124 block grants and fund balance re-appropriated is anticipated to be \$10 million. The net retirement GTB area is anticipated to be \$82.5 million (\$100 – 7.5 – 10 million). If this Retirement were equalized at 175% GTB percentage, 43% or \$35 million of this cost would come from the state. The net increase to the state would be **\$5 million**. This additional state expense would be offset by local property tax reductions. Table 3 summarized the impacts.

Retirement Funding Summary Table 3		
Funding	Current	Proposed
State		
HB 124	\$ 11	\$ -
GTB	\$ 19	\$ 35
Total state	\$ 30	\$ 35
Local	\$ 70	\$ 65
Total	\$ 100	\$ 100

Health insurance costs

Of all the areas of cost in this report, the least information is available on health insurance costs. As structured, this budget item would be in addition to current entitlements. This new budget item is anticipated to be \$60 million per year. This cost may be underestimated for two reasons, 1) health insurance costs are increasing rapidly, and 2) with the costs not being managed by the district, county or state the expense will grow even more rapidly (see analysis section).

The state share of \$60 million equalized at the county level at 175% GTB is **\$26 million per year**. Local property taxes would increase by up to \$34 million. District expenditures could increase by \$60 million.

Analysis of Draft Proposal

Overall Fund Structure

Single General Operating Fund as envisioned by the Fund Structure Working Group (FSWG)

The concept of a General Operating Fund combines the current general, transportation, and retirement funds into a single fund with no sub-funds. In the November 1 discussions the Council considered having sub-funds within the General Operating Fund. The FSWG also discussed having sub-funds within the General Operating Fund, but decided sub-funds do not achieve the objectives of simplicity and flexibility. The FSWG felt that having sub-funds within a fund 1) was not simple because having to account for sub-funds separately is more work than having separate funds, and 2) the inability to move revenue between the sub-funds did not create added flexibility.

For the purpose of this analysis, the General Operating Fund is assumed to be a single fund with no sub-funds.

How the BASE Funding was evaluated

This analysis compares and contrasts the draft proposal to current law under three criteria: Accountability, Equity, and Efficiency. These items are defined below. The council has also been interested Adequacy, Simplicity, Flexibility and Tax Equity.

Simplicity, Flexibility and Tax Equity are all improved with the draft proposal and have been discussed previously, so no analysis is presented in this report.

Adequacy

Various groups and individuals believe that current the funding formula is not representing the costs to adequately fund a quality education and would like the Council to pursue improvements in that area. Although the Council feels this is a critical issue, it also recognizes that an Adequacy study requires expert assistance and more time in order to accurately develop.

Adequacy should be addressed more fully, but there is currently not enough information to determine what is needed. Attempts to improve the adequacy of the formula should not compromise the accountability, equity, or efficiency of the system.

What are Accountability, Equity, and Efficiency in school funding?

Accountability

The system needs to be accountable to the citizens of Montana. Tax revenues collected for a purpose need to be used for that purpose and the entity that makes decisions is held accountable for those decisions.

Equity

The system must guarantee that significant differences in resources available to districts must be due to “educationally relevant” differences of the districts. Districts with similar circumstances should have similar funding available.

Efficiency

The system needs to promote efficient use of resources. If a system does not give incentives to use resources efficiently, wasteful practices will emerge. When the public sees the waste, schools will lose taxpayer support.

These three components are necessary for 1) the integrity of the funding formula and 2) the legal requirement of the state to provide an equitable system.

Analysis of Accountability, Equity, and Efficiency

The single General Operating Fund and countywide equalization do not threaten the Accountability, Equity, and Efficiency of the funding system. Yet some aspects of the options discussed at the November 1 meeting could undermine these goals.

The following section will review each component of the BASE budget, both current and proposed with respect to Accountability, Equity, and Efficient use of resources. It will also offer options to improve equity, accountability, and efficiency without sacrificing the Council’s goals of simplicity, flexibility, and tax equity.

General Operating Fund BASE Component Analysis		
Table 1		
General Fund	Current System	Proposed System
Accountability	Reasonable	Reasonable
Equity	Soft caps	Reasonable, soft caps replaced with averaging
Efficiency	Reasonable	Reasonable
Transportation		
Accountability	SB436 concerns	Concern with funds raised for one purpose and used for another
Equity	Concerns with differences not being defensible	Concerns with differences not being defensible
Efficiency	Reasonable	Concerns with not enough taxpayer self interest to review expenditures
Retirement		
Accountability	SB436 and raising revenue for other funds concerns	Concern with funds raised for one purpose and used for another
Equity	Concerns with differences not being defensible	Concerns with differences not being defensible
Efficiency	Concerns with not enough taxpayer self interest to review expenditures	Concerns with not enough taxpayer self interest to review expenditures
Health Insurance		
Accountability	See General Fund	Concern with funds raised for one purpose and used for another
Equity		Concerns with differences not being defensible
Efficiency		Concerns with not enough taxpayer self interest to review expenditures

Current BASE Budget: Accountability, Equity, and Efficiency

Originally the current funding formula was designed to meet these criteria fairly well. In recent years, some of the accountability and equity of the formula have been eroded by legislative action under pressure from districts to “do something”. At present the current system raises concerns in the areas of Accountability, Equity, and Efficiency.

- Accountability concerns stem from two reasons:
 - The newly added transferability of funds under SB436. When funds are allowed to be raised permissively, or voted for use within a specific fund, then allowed to be transferred to another fund for a “like” purpose, questions may be raised. That is, if the purpose were truly the same or “like” purpose as original fund, then why would the transfer need to occur?
 - The current Retirement fund can be used to fund the retirement of persons employed by any fund. Food service employees, bus drivers, employees hired with grant funds, and all other district employee’s retirement may be funded with the retirement fund. The FSWG questioned whether or not this good accounting policy.
- Equity concerns stem from the inability to tie differences in expenditures for transportation and retirement to educationally relevant differences. The current equity concerns by fund are:
 1. General Fund – the soft caps are developed to allow districts to maintain a prior year budget when enrollment declines. Equity issues arise because not all district with declining enrollment will choose soft caps and greater than 25% window will exist. Approximately 12% or 54 districts are currently using soft caps.
 2. Transportation - there is some question whether or not transportation is required to be equalized so equity is less of a concern.
 3. Retirement expense is required and the state needs to provide equitable funding. As shown below, the differences in retirement expenditures are substantial.

Current law allows districts to budget any amount for retirement. The amount per ANB that districts budget varies widely. Within similar sized districts with same programs, elementary, high school or both, the difference at the 95th and 5th percentile can be in excess of 200%. In other words for similar districts, the 95th percentile districts is budgeting three times the amount of the 5th percentile district.

The highest budgeting districts tend to be those with high all fund expenditures. These tend to fall into two categories: 1) high wealth districts that have above maximum general fund budgets, and 2) high impact aid districts. Both of these types of districts have the additional resources to hire significantly more staff than other districts. The Retirement Fund allows these high spending districts the ability to stretch their own resources further by having the Retirement Fund pay for the retirement of the additional staff. Effectively, the remainder of the county gives additional funds to the high resource districts. This exacerbates the inequities among districts.

- Efficiency - The primary concern is that there is little taxpayer self interest in the

efficient use of funds in the retirement fund. When the responsibility for raising all revenue is the county and state, while the responsibility for efficient operation is the district, there is little incentive to contain costs. The district does not need to explain its expenditures to the taxpayers.

BASE budget of the Draft Proposal

The draft proposal addresses none of the current concerns with the Accountability, Equity, or Efficiency in the current system and creates new concerns.

District transportation budget as determined by the trustees

Proposed

- 1) Accountability - Districts could budget an unlimited amount for transportation and collect revenues specifically for transportation. However, they could spend the money funds on any general operating expense. If a district raised a substantial sum for transportation then spent it elsewhere, it would misrepresent the budget to the taxpayers.
- 2) Equity – no change from the concerns with the current formula.
- 3) Cost efficiency - If the county and state pay for all transportation costs, then districts lack incentives to contain transportation costs. Under the current system all costs above the state formula are born by local taxpayers, which motivates interest of local taxpayers in containing those costs. The pressure to contain costs would drop if the district did not have to be responsible for the levy.

Alternative

It may be possible to include transportation in the general operating fund and still maintain accountability, equity, and cost-efficiency. A new formula that more accurately reflects costs could replace the current formula and serve to establish the BASE.

We could allow a portion of the 25% over-BASE budget to be permissive instead of voted, like the current over-BASE amounts. This formula would more closely follow the current system of districts setting their own transportation budgets.

Such a formula would provide accountability, because it limits the budgets and focuses on anticipated costs. It would also maintain equity, because it would stem from the estimated cost of providing transportation services to students in the district; it would be educationally relevant. It would help contain costs by keeping the incremental costs for transportation at the local level.

Overall there is no reason to keep transportation out of the General Operating Fund. Yet the final recommendations need to ensure accountability, equity, and cost-efficiency for the long-term success of the system.

District retirement budget as determined by the trustees

Proposed

The current law and the proposed retirement funding proposal contain many of the same concerns except the draft proposal adds one concern in accountability:

- 1) Accountability – Districts could budget an unlimited amount retirement and collect revenues specifically for retirement. However, they could spend the money funds on any general operating expense. If a district raised a substantial sum for retirement then spent it elsewhere, it would misrepresent the budget to the taxpayers.

Alternative

There could however be an alternative that would meet the needs of districts, while improving accountability, equity and efficiency. Retirement costs are a direct function of staff salaries. Statewide there is a high level of consistency as to the percentage of the budget that consists of salaries. The percentage is higher in elementary programs than in high schools and it is higher in larger schools than in smaller schools. The current entitlements could be increased to accommodate retirement expense because like other general fund expenditures retirement is primarily a function of number of ANB.

This alternative would maintain equity, because it is based on the estimated cost of providing retirement to employees in the district, i.e. educationally relevant. It would also provide better accountability, because the budget is limited within the range of educationally relevant. It also adds efficiency incentives as it keeps the incremental costs for retirement at the district level and maintains self-interest at the local level for containing costs.

District health insurance costs as determined by the trustees

Proposal

Clarification of exactly which health insurance costs could be charged to the general fund BASE as in this plan needs to be developed. The following questions arise.

- 1) Can health insurance costs of employees of all funds be included in this BASE levy?
- 2) Can the health insurance include dental, eyeglasses, orthodontics, and prescription drugs?
- 3) Can the health insurance cover more than the employee? Is there any employee share to the plan? Are there deductibles required?
- 4) Is there a minimum number of hours that must be worked for an employee to qualify?
- 5) Can coverage be provided in the summer or non-working months to teaching, non-teaching or part-time staff?
- 6) Are there any limits to the amount per employee or per ANB that can be charged to this levy?

Concerns with Health Insurance funding proposal:

- 1) Accountability - Districts could budget an unlimited amount health insurance and collect revenues specifically for health insurance. However, they could spend the money funds on any general operating expense. . If a district raised a substantial sum for health insurance then spent it elsewhere, it would misrepresent the budget to the taxpayers.
- 2) Equity - non-educationally relevant differences in excess of 25% will occur. Districts with significant resources available will have more staff and more health insurance costs than do districts with fewer resources. Currently some districts offer no health insurance and some have health insurance plans with very high benefits. The variance in benefits among districts in the general fund is from 0 to 20 percent of salaries. If health insurance was funded based on district choices it will cause equity concerns.
- 3) Efficiency – similar to transportation and retirement, if the county and state pay for all health insurance costs, then districts lack incentives to contain costs.

Given the current employer employee relationship that is involved with the health insurance benefits and the constitutional management control of districts, limiting the benefits or costs to the program at the state level seems problematic.

If health care costs are a problem, alternative solutions should be posed that continue accountability, equity, and incentives for cost containment. The proposed solution alleviates the responsibility of districts to manage costs and sends the bill to the taxpayers.

Whenever the persons who choose the benefits, districts in this case, are not the ones that have to pay for it, the incentive for cost containment and efficiency is lost. The draft proposal creates this type of situation. The district can choose any health insurance plan and have the county and the state pay for it. There will be little incentive for the district to manage this difficult to manage cost.

Alternative

Health insurance is a broad issue that should be defined in the context of statewide health insurance policy and school funding combined. I recommend continued investigation in to the possibilities and work with the interim legislative committee working on SJR 22, statewide health insurance issues.

Over-BASE portion of the Draft Proposal

No over-BASE levy for transportation, retirement and health insurance

Long-term concern – non-accountability, equity, efficiency

We have currently adopted a 25% window, where the maximum budget is 25% more than the minimum budget or BASE budget. If no over-BASE levy were allowed on a portion of the BASE budget the window would effectively be less than 25% of the new BASE budget. Districts may argue that the window should then be expanded to be a full 25% more than the BASE, which would dramatically increase the over-BASE area of the budget. This would further compound concerns of equity parts of the new BASE are inequitably derived, as shown in the previous sections.

Fund balance re-appropriated and district sources of non-levy revenue would now be applied to the over-BASE budget.

Proposed

Accountability – This proposal would automatically increase the over-BASE budget by the non-levy revenue and fund balance re-appropriated in the general fund, transportation, and retirement funds. Taxpayers in the district may choose to use these funds to reduce local property taxes instead of increasing the over-BASE budget.

Equity - An advantage to placing non-levy revenue and fund balance re-appropriated over-BASE is it removes the incentive for districts to spend less than the BASE budget and may provide greater equity in spending.

Alternative

The Council may wish to consider changing the over-BASE voting requirements back to voting budget authority rather than tax increases so that taxpayers approve any budget in excess of the BASE.

Conclusion

Our current system of school funding has concerns with regard to accountability, equity, and efficiency. Any changes in the formula should improve these aspects of the funding formula. If the formula lacks accountability, equity, and efficiency, the taxpayers will not support the funding formula and will not support schools. All of government rests on the trust of the people in the institutions that they support with taxes. A strong school funding system will contain provisions to ensure accountability, equity, and efficiency.

Some of the proposals considered by the Council could compromise the accountability, equity, and efficiency of the school funding system. Modifications to the proposal can remedy most of these issues and may improve confidence of the public in the financial aspect of our schools.

Questions

1. Does the Council recommend a single General Operating Fund?
2. Transportation -
 - Should the BASE amount for the Transportation component of the General Operating Fund be 1) individually determined by each district, or 2) calculated based on educationally relevant differences among districts?
 - Should a portion of the over-BASE budget area of transportation be permissive?

- Should the state continue to pay a percentage of the “on-schedule” transportation before GTB aid is used?
 - Should the definition of “on-schedule” be updated to be consistent with current practice of transportation for students?
3. Retirement –
- Should the BASE amount for the Retirement component of the General Operating Fund be 1) individually determined by each district, or 2) calculated based on educationally relevant differences among districts?
 - Should a portion of the over-BASE budget area of transportation be permissive?
4. Health Insurance –
- Should health insurance have its own component of the BASE budget?
 - Should the BASE amount for the Retirement component of the General Operating Fund be 1) individually determined by each district, or 2) calculated based on educationally relevant differences among districts?
5. OverBASE –
- Should the voting requirements for the overBASE portion of the budget consider increased taxes or authority to increase budgets?